Recent trends in TOGCs

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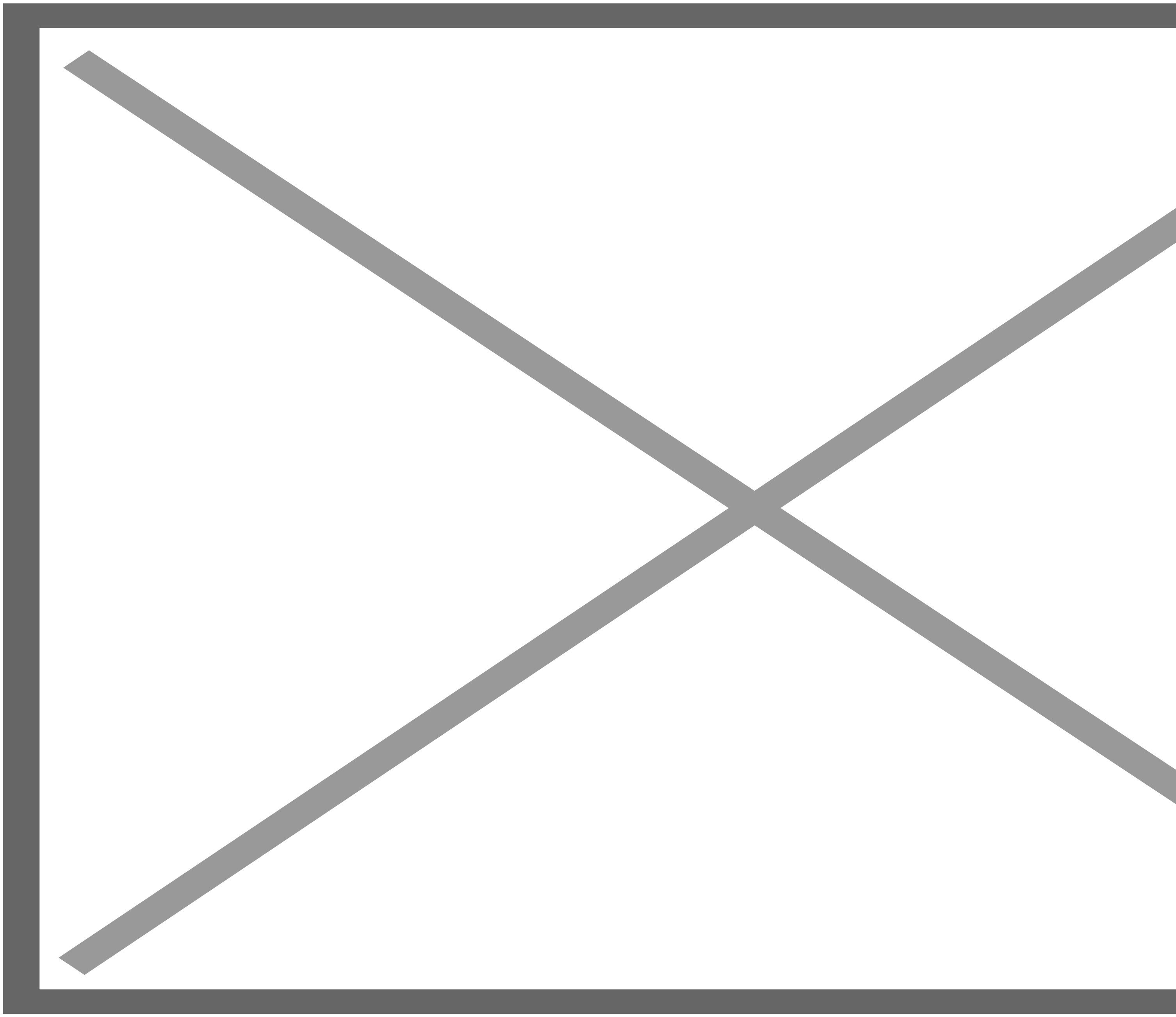

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Michael Hunter and *Charlotte Fallon* dwell on the recent trends in assessing TOGCs

Recent case law concerning TOGCs continues to foster a substance over form approach that, in the UK at least, has its origins in the 1968 case *Kenmir Ltd v Frizzell*. More recently, we have seen a willingness on the part of the UK courts to apply that approach even where nuances of English land law might suggest otherwise. This potentially both stretches and tightens traditional TOGC boundaries and increases the need to temper technical advice with good judgement.

Sub sales

The 1994 case of *Kwik Save Group PLC v Commissioners of Customs and Excise* (Kwik Save) tells us that a typical sub sale cannot be a TOGC. In that case, the sale of food stores to Kwik Save on terms that expressly or impliedly permitted the food stores to be transferred on completion to Kwik Save's separately VAT-registered subsidiary resulted in a supply from the original vendors to Kwik Save and a second supply from Kwik Save to the subsidiary (the sub sale). It was held that the sub sale was not a TOGC because it could not be said that the assets were "to be used by the transferee in carrying on the same kind of business as that carried on by the transferor". (The original vendors carried on business at the stores until close of business on the completion date and the following morning the subsidiary opened the stores, so Kwik Save had never actually carried on the business.) HMRC's guidance also rules out a sub sale saying, at paragraph 2.3.3 of VAT Notice 700/9:

> *"There must not be a series of immediately consecutive transfers of the business. Where A sells its assets to B who immediately sells those assets on to C, because B has not carried on the business the TOGC provisions do not apply to any of the transactions."*

So, where a property owner (A), sells an opted and tenanted property to a buyer (B), who sub sells to a third party (C), neither the A to B, nor the B to C limb can be TOGCs because:

- B has not carried on the same kind of business, as required by Article 5(1)(a)(i) of the Value Added Tax (Special Provisions) Order 1995 in order for its acquisition to be a TOGC; and
- B has not carried on the letting business, hence its transfer to C cannot be the transfer of its business.

However, this does not necessarily mean that all sub-sale/consecutive transfer scenarios automatically fall outside TOGC treatment. What if, for instance, A negotiates to sell to a potential developer (B) who, before entering into a sale contract with A, enters into an agreement for lease (AfL) with a potential tenant (T), conditional on B acquiring the property and on development works being carried out? B might then sub-sell the property, with the benefit of the AfL, to a third party funder (C), who commits to enter into the lease contemplated by the AfL.

The sub sale aspect sets alarm bells ringing. However, are we really in the same scenario as *Kwik Save*? In contrast to the party playing the role of B in the *Kwik Save* case, the B in our revised scenario has clearly been carrying on an economic activity in respect of the property, even if it did not actually own the legal title at that point. To quote HMRC (5th bullet, paragraph 6.2, Notice 700/9), surely there is "sufficient evidence of intended economic activity for there to be a property rental business capable of being transferred". The VAT Tribunal case of *Dartford Borough Council v HMRC* (VTD 20423) provides support, in pretty bullish terms, for the conclusion that the AfL is itself a business that can be the subject of a TOGC and to refer again to the HMRC guidance cited above, HMRC give the following example of when they consider a property business can be transferred as a TOGC:

> *"If you: …*
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> - *own a property and have found a tenant but not actually entered into a lease agreement when you transfer the freehold to a third party (with the benefit of a contractual agreement for a lease but before the lease has been signed), there is sufficient evidence of intended economic activity for there to be a property rental business capable of being transferred."*

So the key question is whether the fact that B has owned the property for a scintilla of time (or even procured its transfer from A directly to C) means it cannot treat the property as an asset of this business. This does seem to fly in the face of this continuing theme of substance over form.

Whilst this is clearly a grey area, it is likely on the facts that there will be additional features which make for a much more compelling TOGC case. For instance, it is unlikely B would go to the trouble of finding a tenant and entering into an AfL without at least having an agreement or option to acquire the site (and this would almost certainly be so before B carries out any works on the property). To adopt an approach that B needed to have the actual land interest it was transferring for a period (rather than relying on its right to call for the land under an agreement or option) seems to be focusing too much on what land interest is held/transferred, rather than the more substantive question as to whether a business is being transferred – i.e. exactly the type of approach disapproved of in the First Tier tribunal case *Robinson Family Limited* [2012] UKFTT 260.

Split interests

Post Intelligent Managed Services v HMRC [2015]UKUT 0341 (IMSL), a number of situations that would not previously have been considered TOGCs now appear to fulfil the necessary criteria as a result of the conclusion that 'business' takes its ordinary meaning and is not understood in terms of supplies for VAT purposes. Judging where the boundaries of this approach lie is not always straightforward, however.

IMSL concerned the sale of banking support services to a VAT group. The Upper Tribunal found that the transfer was a TOGC, notwithstanding that the only supplies made by the transferee were within a VAT group (of which the transferee was not the representative member), on the basis that, following *Skandia* in the CJEU (CJEU C-7/13), the acquirer was the VAT group, not the individual VAT group member and the group should be looked at on the basis that it was carrying on all the businesses carried on by its members.

Historically, where assets were held in a separately VAT-registered a Propco-Opco structure, a buyer would typically replicate that structure to avoid concerns that the rental business ceased if both businesses were transferred to a single entity or to a single VAT group.

Following *IMSL*, concerns about not VAT grouping on the buy side if there was not a VAT group on the sell side seem to have fallen away. Conversely, the requirement to focus on, or take account of, separate businesses within a VAT group may in some cases require separate activities (e.g. property rental and retail operational activities) to be maintained on the buy side, even within a VAT group.

Unmerged interests

If a seller holds unmerged interests in the same property (e.g. the freehold and a head lease, with occupational leases having been granted out of the head lease) and has opted the property during the course of his ownership, can only the sale of the head lease be a TOGC or could this also be said of the freehold?

The answer is likely to revolve very much on the specific facts. For instance, if the head lease only has a short period in which to run, arguably it forms part of the property rental business being transferred. Alternatively, if there are rights reserved with the freehold (for instance, a requirement on the long lessee to obtain consent to sub-let or alter the premises) it may be possible to say that it would form part of the assets of the seller's letting business. Where part of the seller's income stream relies on the continuing existence of the head lease (as will be the case if service charges payable under the occupational leases rely on service charge provisions in the head lease), arguably both the freehold and the head lease together comprise the third party property rental business as there are real commercial reasons for holding the interests on an ‘unmerged’ basis.

Whose business is it anyway?

The Upper Tribunal case of *Royal College of Paediatrics and Child Health v Commissioners for HMRC* [2015]UKUT 0038 (Royal College) is a timely reminder to the taxpayer that an approach that favours substance over form cuts both ways.

In that case, the College identified a building which was vacant but being actively marketed as available for let and, before the freehold of the building was sold to the College, an affiliated college (which was already letting part of the College’s current premises) entered into a lease agreement with the vendor over one room, for 15 years and conditional on the sale to the College.

The College was successful before the FTT but HMRC successfully appealed. At paragraph 42 of its judgment, the UT noted that European case law was clear that there had to be both the transfer of an asset and something more for there to be a TOGC and at paragraph 43, the UT commented:

“In a normal case of the transfer of a freehold, no doubt it is enough for the extra element to be a transfer of a lease to a tenant or even an agreement with a putative tenant to do so. ***As long as that lease which is transferred (or the agreement) can truly be said to have been part of the seller’s business then the requirements of the law will be satisfied****… However here the agreement for a lease was not part of the seller’s business at all.* ***The putative tenants were never part of [the vendor’s] business, they came from the purchaser. The agreement arose directly from and was simply part of the sale transaction.*** *No part of seller’s business was transferred to the buyer. For this reason the transfer was not a transfer of a going concern.” (our emphasis)*

The distinction the UT made, between what forms part of the seller’s business and arrangements that are simply part of the sale transaction, is a telling one (and potentially relevant to the AfL in the first situation considered above) and against this backdrop any situation that involves a co-tenant or sub-lessee of the buyer becoming the tenant of the seller in advance of the sale is likely to fall foul of *Royal College* and, more generally, of an approach that favours substance over form.

Recent case law on ‘abusive practices’ only underlies the overriding significance of this substance over form principle. The CJEU in the *Newey* case (CJEU C-653/11, [2013] S.T.C. 2432) considered a similar point and looked at the economic reality of arrangements. The Supreme Court in the recent *Pendragon* case [2015]UKSC 37 took a similar approach so any court asked to review this sort of situation will be conducting their review in the climate produced by these two cases, neither of which were sympathetic to what the courts saw as artificial schemes based on an overly technical interpretation of the law.

In conclusion

A substance over form approach which potentially extends even to features of transactions dictated by UK land law increases the need for technical advice to be wedded to commercial reality. Working out whether a situation amounts to a TOGC is not simply a tick box exercise or one where accepted principles or HMRC guidance can be artificially incorporated into a transaction outside their proper context to achieve a beneficial result. More than ever, it is necessary to take the trouble to step back and ask whether a ‘real’ business is being carried on by the transferor and transferred to the transferee in a way that enables the transferee to continue it and not to be overly-fixated on technical distinctions of English, Welsh and Scottish land law and the nature of land interests.